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BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILILAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

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IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN

Docket No. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS

Docket No. T-00000D-00-0672

NOTICE OF FILING REBUTTAL
TESTIMONY

The Arizona Corporation Commission Staff ("Staff") hereby files the Rebuttal
Testimony of Elijah Abinah and Matthew Rowell in support of the Proposed Settlement on behalf of
the Utilities Division Staff.

RESPECTFULLY submitted this 28th day of October, 2005.

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REBUTTAL

TESTIMONY

OF

ELIJAH O. ABINAH

MATTHEW ROWELL

DOCKET NO. T-01051B-03-0454

DOCKET NO. T-00000D-00-0672

**IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION PLAN**

AND

**IN THE MATTER OF THE INVESTIGATION OF
THE COST OF THE TELECOMMUNICATIONS ACCESS**

OCTOBER 28, 2005

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S) DOCKET NO. T-01051B-03-0454
FILING OF RENEWED PRICE REGULATION)
PLAN)
_____)

IN THE MATTER OF THE INVESTIGATION OF) DOCKET NO. T-00000D-00-0672
THE COST OF THE TELECOMMUNICATIONS)
ACCESS)
_____)

REBUTTAL

TESTIMONY

OF

ELIJAH O. ABINAH

FOR THE

ARIZONA CORPORATION COMMISSION

UTILITIES DIVISION

OCTOBER 28, 2005

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EXECUTIVE SUMMARY
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672

My testimony responds to RUCO Witness Marylee Diaz Cortez's testimony on the treatment of the April 1, 2005 Productivity Adjustment. I disagree with Ms. Diaz Cortez's statement that ratepayers do not receive the full benefit of this reduction under the terms of the Proposed Settlement Agreement. The Settlement Agreement provides for an immediate reduction in Qwest's revenue requirement for Year 1 of \$12 Million which is to be allocated to Basket 2. This amount represents the value of the April 1, 2005 Productivity Adjustment. The allocation was made to Basket 2 under the Settlement Agreement, because it contains some services that are in Basket 1 under the current Plan. While Ms. Diaz Cortez believes that basic rates should be reduced by the amount of the Adjustment, instead of the treatment proposed in the Settlement Agreement. Staff believes that RUCO's credit proposal however, may lead to customer confusion. In addition, this would have been an unlikely outcome even if Qwest had gone ahead and made the adjustment when required. Under the existing Plan, Qwest has discretion to apply the adjustment to any Basket 1 services it desires.

Staff and the parties to the Settlement Agreement worked very hard to reach an outcome that was beneficial to consumers and was fair, just and reasonable. Staff believes that the proposed Settlement Agreement and Revised Plan is in the public interest and should be approved by the Commission.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Elijah O. Abinah. My business address is 1200 West Washington Street,
4 Phoenix Arizona, 85007.

5
6 **Q. Where are you employed and in what capacity?**

7 A. I am employed by the Utilities Division ("Staff") of the Arizona Corporation Commission
8 ("ACC" or "Commission") as an Assistant Director.

9
10 **Q. How long have you been employed with the Utilities Division?**

11 A. I have been employed with the Utilities Division since January 2003.

12
13 **Q. Are you the same Elijah O. Abinah who provided earlier testimony in this matter?**

14 A. Yes.

15
16 **Q What is the purpose of your testimony?**

17 A The purpose of my testimony is to address the Residential Utility Consumer Office
18 ("RUCO") Supplemental Testimony of Marylee Diaz Cortez, specifically on the issue of
19 the April 1, 2005 Productivity Adjustment. Mr. Rowell will address RUCO's first five
20 concerns with the Settlement Agreement which are identified on page 2 of Ms. Diaz
21 Cortez's testimony and which are discussed in Dr. Johnson's testimony.

22

APRIL 1, 2005 PRODUCTIVITY ADJUSTMENT

Q. What is the Productivity Adjustment and why is the April 1, 2005 Productivity Adjustment an issue in this proceeding.

A. Pursuant to Commission Decision No. 63487, and the provisions of the existing Price Cap Plan, Qwest was required to make a Productivity Adjustment or an annual price reduction in Basket 1 when productivity exceeded inflation. Such reduction was to be made on April 1 of each year.

Because of issues relating to Qwest's financial statements at the time it submitted its application for renewal of its existing Plan, the Commission was unable to approve a new or modified Plan by the date the existing Plan was to expire. Under the Continuation Clause of the Plan, all of the terms of the Plan were to remain in effect until the Commission entered an Order approving a new or modified Plan, or terminated the existing Plan. In Decision Nos. 66772 and 67047, the Commission interpreted this as including the productivity factor, since it was an integral part of the Plan. On February 3, 2005, Qwest sought a suspension of the Productivity Adjustment pending the outcome of settlement discussions. In Decision No. 67734, the Commission suspended the April 1, 2005 Productivity Adjustment until final rates are set in this case. The Commission put the burden on Qwest of demonstrating that the terms of any Renewed Plan or other form of rate regulation that may ultimately be approved, whether produced by settlement or through litigation, include full credit for the value of the April 1, 2005 Productivity Adjustment being given to ratepayers.

Qwest also appealed the various Commission orders interpreting the provisions relating to the Productivity Adjustment and the Continuation Clause and those appeals have been

1 consolidated in the Arizona Court of Appeals and the Superior Court of Arizona.
2 Paragraph 28 of the Proposed Settlement Agreement deals with the dismissal by Qwest of
3 those appeals.
4

5 **Q. Pursuant to the Commission's Decision No. 63487, what was the Productivity**
6 **Adjustment rate?**

7 **A.** The Productivity Adjustment rate was set at 4.2 percent.
8

9 **Q. On page 3 line 8 of Ms. Diaz Cortez's testimony, she stated that the Productivity**
10 **Adjustment Rate was 4.8 percent. Does Staff agree with the quoted rate?**

11 **A.** No. As stated earlier, the Productivity Adjustment rate was set at 4.2 percent.
12

13 **Q. Did Qwest make the required Productivity Adjustment in April 2002, 2003 and 2004?**

14 **A.** Yes.
15

16 **Q. Did Qwest provide Staff with the dollar amount of reduction associated with the April**
17 **1, 2005 Productivity Adjustment?**

18 **A.** Yes.
19

20 **Q. What was the amount?**

21 **A.** Based on the information provided by the Company that was verified by Staff, the amount
22 is approximately \$12 million dollars.
23

1 **Q. Did Qwest make the April 1, 2005 reduction?**

2 A. No. Qwest did not make the required reduction because, as discussed earlier, Commission
3 Order 67734 suspended the required adjustment to allow for comprehensive settlement
4 discussions between the parties and to avoid customer confusion. The Commission further
5 found in Finding of Fact 19 that it was in the public interest to allow Qwest to suspend the
6 implementation of the April 1, 2005 Productivity Adjustment until final rates are set in this
7 docket, as long as the consolidated appeals were suspended for a similar time period.
8 However, the liability associated with the April 1, 2005 adjustment would continue to
9 accrue, in accordance with the terms of the Continuation Clause of the Price Cap Plan.

10
11 **Q. Was Qwest required to apply the Productivity Adjustment to any particular service?**

12 A. No. Qwest has the discretion under the existing Plan to apply the reduction to any
13 service(s) it chooses. The only requirement on Qwest is that the reduction has to take place
14 in Basket 1.

15
16 For example, price reductions associated with the April 1, 2002 Productivity Adjustment
17 for Year 1 under the existing Plan were made to the following services: (1) non-recurring
18 charges for business and residence custom calling and listings; (2) basic business services
19 non-recurring and recurring rates; and (3) digital switched service and uniform access
20 solution rates.

21
22 For Year 2 of the existing Plan, Qwest made price reductions associated with the April 1,
23 2003 Productivity Adjustment to the following services: (1) the residential additional line
24 rate; (2) basic business service non-recurring and recurring rates; (3) custom calling feature

1 recurring rates; (4) market expansion line rates; (5) hunting service rates, and (6) residence
2 package rates.

3
4 For Year 3 of the existing Plan, Qwest made price reductions associated with the April 1,
5 2004 Productivity Adjustment to the following services: (1) the residential additional line
6 rate; (2) basic business service recurring rates; (3) business listing service rates; (4) market
7 expansion line rates, (5) basic exchange enhancement rate and (6) residential package rates.

8
9 **Q. Does the Revised Price Cap Plan agreed to by the parties to the Proposed Settlement**
10 **Agreement provide for continuation of the Productivity Adjustment.**

11 A. No, the Productivity Adjustment is eliminated in the Revised Price Cap Plan. Staff did not
12 support continuation of the Productivity Adjustment for the reasons given in Mr. Rowell's
13 original testimony.

14
15 **Q. Please briefly identify the sections of the Proposed Settlement Agreement that address**
16 **the April 1, 2005 Productivity Adjustment.**

17 A. Sections 7 contains the parties' agreement concerning the April 1, 2005 Adjustment and
18 Sections 10 and 11 of the Settlement Agreement address how the April 1, 2005
19 productivity factor will be allocated. Attachment 1 to my testimony contains copies of
20 these provisions.

21
22 **Q. Can you please briefly summarize the provisions of the Settlement Agreement**
23 **regarding the April 1, 2005 Productivity Adjustment?**

24 A. Yes. Section 7 of the Proposed Settlement Agreement provides that Qwest's obligation
25 with regard to the April 1, 2005 Productivity Adjustment will be satisfied by a \$12.0

1 Million reduction in its allowable net increased revenue from price changes for the first
2 year of the Plan. Section 10 of the Proposed Settlement Agreement describes how the
3 reduction described in Section 7 is to be implemented. It provides for subtraction of the
4 \$12.0 Million associated with the Productivity Adjustment from Qwest's allowable net
5 increase in revenues for Year 1 of the Plan. Finally, Section 11 of the Proposed Settlement
6 Agreement explains how Qwest's allowed revenue increase will be allocated between the
7 various baskets for each year of the Plan. Section 11 provides that the full \$12.0 Million
8 Productivity Adjustment shall be allocated to Basket 2 such that Qwest may only obtain
9 \$1.8 Million in additional revenues from Basket 2 in Year 1 of the Plan.

10
11 **Q. RUCO takes issues with the Proposed Agreement's allocation of the April 1, 2005**
12 **Productivity Adjustment to Basket 2. Why does Staff believe that allocation of the**
13 **April 1, 2005 Productivity Adjustment to Basket 2 is appropriate?**

14 **A.** Staff believes that applying the \$12.0 million to Basket 2 is appropriate because it is in line
15 with how the Productivity Adjustment has been applied in the past. During the three years
16 (2002 – 2004) that the Productivity Adjustment was applied, Qwest reduced the rates of 15
17 different services. Of those 15 services, 9 of them are included in the proposed Basket 2
18 under the proposed Settlement Agreement. Thus, Staff believes that applying the \$12.0
19 million to Basket 2 most closely approximates Qwest implementation of the Productivity
20 Adjustment over the years.

21
22 **Q. If Qwest had simply made the April 1, 2005 reduction, what is the likelihood that**
23 **residential rates would have been reduced?**

24 **A.** Assuming that Qwest had simply made the Productivity Adjustment for April 1, 2005, and
25 given the history of its past adjustments, it is unlikely that any Adjustment would have

1 been made to basic residential rates. At no time since the current plan was approved has
2 the residential basic rate decreased as a result of the operation of the Productivity
3 Adjustment. Thus, Staff does not believe that RUCO's proposal to apply the entire \$12.0
4 million adjustment to basic rates reflects what was likely to occur had Qwest made the
5 April 1, 2005 Adjustment.

6
7 **Q. Why does Staff believe that the proposed Settlement Agreement satisfies the April 1,**
8 **2005 Productivity Adjustment?**

9 **A.** Staff believes that the provisions of the Proposed Settlement Agreement satisfy the April 1,
10 2005 Productivity Adjustment because there is an immediate \$12.0 Million reduction in
11 Qwest's revenue requirement for Year 1 of the Plan. Both residential customers and
12 business customers will benefit from this because Basket 2 contains ancillary services and
13 additional lines for both residential and business customers. With application of the April
14 1, 2005 Productivity Adjustment, Qwest will only have the opportunity to raise rates in this
15 basket by \$1.8 Million in Year 1. Thus, customers will benefit from not incurring an
16 increase in rates for certain services that might otherwise could occur absent the
17 adjustment.

18
19 **Q. Ms. Diaz Cortez, on page 6 lines 14 through 19, recommends that "all Qwest IFR and**
20 **IFB customers receive a credit on their monthly bills equal to a twelve month**
21 **amortization of the value of the April 1, 2005 Productivity Adjustment that was**
22 **foregone during the suspension period." Does Staff agree with that recommendation?**

23 **A.** No. Staff believes that issuing a credit that will decrease the monthly rate and then turn
24 around and increase it when the credit is no longer applicable will simply confuse the end
25 user. The primary point, however, I would like to make is that a settlement reflects a

1 compromise on the major issues in any case. Staff believes that there are many provisions
2 in the Proposed Settlement Agreement which benefit residential customers, including the
3 fact that under the proposed Price Cap Plan, residential rates cannot increase beyond
4 current levels for the Plan's term again. RUCO, in its pre-filed testimony, had identified a
5 revenue requirement of approximately \$160,000,000. Under the Proposed Settlement
6 Agreement, the parties have agreed to a revenue requirement of \$31.8 Million. In addition,
7 under the Proposed Settlement Agreement, the consolidated appeals will be dismissed as
8 provided in Paragraph 28 of the Agreement, another significant benefit because of the
9 litigations risks involved with any appeal.

10
11 The parties to the Settlement Agreement and Staff worked very hard to ensure an outcome
12 that is fair, just and reasonable to the end-user and the Company under the Agreement.
13 Staff believes that the Proposed Settlement Agreement is in the public interest and request
14 that the Commission approve the Agreement.

15
16 **Q. Does this conclude your testimony?**

17 **A. Yes it does.**

Section 7. April 1, 2005 PRODUCTIVITY ADJUSTMENT

This Settlement Agreement recognizes that the Commission's Decision No. 67734 suspended the Productivity Adjustment to prices that Qwest would have made to Basket 1 of the original Price Cap Plan on April 1, 2005, under the Commission's interpretation of that Plan. Under Decision No. 67734, Qwest is obligated to demonstrate that final rates approved in this docket result in ratepayers receiving the full value of the suspended April 1, 2005 Productivity Adjustment as if it had been effective April 1, 2005. The Parties agree that Qwest's obligation under Decision No. 67734 is satisfied by the 12.0 million reduction in its allowable net increased revenue from price changes for the first year of the Plan as set forth in Section 10 of this Agreement.

Section 10. OPPORTUNITY FOR PRICE CHANGES PERMITTED UNDER THE PLAN

The Parties agree that Qwest shall be granted the opportunity to increase its revenue through limited price changes during the terms of the Renewed Plan. The revenue increases shall be derived from Baskets 2 and 3 of the Plan as described in this Section 10 and in Section 11.

In Year 1 of the Plan, the allowable net increase in revenues resulting from price changes shall not exceed \$31.8 Million, allocated between Baskets 2 and 3 of the Plan, as set forth in Section 11. The \$31.8 Million of allowable net increased revenue from price changes is determined by starting with the \$31.8 Million revenue deficiency set forth in Section 2 of this Agreement, adding \$12.0 Million to offset the Switched Access Charge reduction set forth in Section 8 of this Agreement, and subtracting \$12.0 Million for the April 1, 2005 Productivity Adjustment identified in Section 7 of this Agreement.

In Year 2 of the Plan, and in subsequent years in which the Plan is in effect, Qwest will be allowed to implement net price changes for services in Baskets 2 and 3 that increase annual revenues no more than \$43.8 Million (which represents the \$31.8 Million revenue deficiency plus \$12.0 Million to offset the Switched Access Charge reduction). It is the intent of the Parties that under no circumstances will the overall increase in annual revenues from net price changes exceed \$43.8 Million during the term of the Renewed Plan.

The Parties agree that the rate changes specifically set forth in this Agreement (together with any applicable resale discounts) and the pricing flexibility for Basket 2 and 3 Services under the Renewed Price Cap Plan result in just and reasonable rates for Qwest's Arizona intrastate operations.

Section 11. ALLOCATION OF PRICE CHANGE OPPORTUNITY BETWEEN BASKETS 2 AND 3

For Year 1, the overall net revenue increase resulting from price changes shall not exceed \$31.8 Million and shall be allocated as follows: any amount up to and not exceeding \$1.8

ATTACHMENT 1

Million shall be allocated to Basket 2 (\$31.8 Million less \$12.0 Million for the April 1, 2005 reduction identified in Section 7 of this Agreement) and the remainder of the aggregate \$31.8 Million not used for Basket 2 shall be allocated to Basket 3.

For Year 2 of the Renewed Price Cap Plan, and for subsequent years in which the Renewed Price Cap Plan is effective, the overall net revenue increase from price changes shall not exceed \$43.8 Million (\$31.8 Million revenue deficiency set forth in Section 2 of this Agreement plus the \$12.0 Million Switched Access Charge reductions set forth in Section 8 of this Agreement) and shall be allocated as follows: any amount up to and not exceeding \$13.8 Million shall be allocated to Basket 2 and the remainder of the aggregate \$43.8 Million not used in Basket 2 shall be allocated to Basket 3.

The additional Consumer Benefits identified in Section 13 shall not be accounted for in determining price and revenue changes pursuant to Sections 10 and 11 of this Settlement Agreement.

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER

Chairman

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IN THE MATTER OF QWEST CORPORATION'S)
FILING OF RENEWED PRICE REGULATION)
PLAN.)

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION)
OF THE COST OF TELECOMMUNICATIONS)
ACCESS.)

DOCKET NO. T-00000D-00-0672

REBUTTAL

TESTIMONY

OF

MATTHEW ROWELL

CHIEF ECONOMIST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 28, 2005

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EXECUTIVE SUMMARY
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672

This Rebuttal Testimony responds to the Supplemental Testimony of Dr. Ben Johnson, witness for RUCO. Dr. Johnson's Responsive Testimony appears to be inconsistent with the testimony of RUCO witness Marylee Diaz Cortez and his own Direct Testimony at times. Dr. Johnson's Testimony also appears to have several internal inconsistencies and oftentimes does not accurately portray the proposed Settlement Agreement. It also appears to be inconsistent with positions RUCO has taken in at least one other Docket. Staff also is concerned that Dr. Johnson offers no workable solutions to the significant issues in this case.

For the above reasons Staff recommends that the Commission discount Dr. Johnson's recommendation in its deliberations on this matter.

I. Introduction

Q. Please state your name and business address for the record.

A. My name is Matthew Rowell. My business address is: Arizona Corporation Commission,
1200 West Washington Street, Phoenix, Arizona 85007.

Q. Are you the same Matthew Rowell who submitted Supplemental Testimony on behalf of Staff on September 6, 2005?

A. Yes.

Q. What is the purpose of this Rebuttal Testimony?

A. The purpose of this Rebuttal Testimony is to respond to the Supplemental Testimony of RUCO witness Dr. Ben Johnson.

Q. What is your general impression of Dr. Johnson's testimony?

A. Dr. Johnson's testimony is very critical about the Proposed Settlement Agreement reached among the parties to this case (exclusive of RUCO.) However, upon close examination, Dr. Johnson's Responsive Testimony appears to be inconsistent with the testimony of RUCO witness Marylee Diaz Cortez and his own Direct Testimony at times. Dr. Johnson's Testimony also appears to have several internal inconsistencies and oftentimes does not accurately portray the proposed Settlement Agreement. It also appears to be inconsistent with positions RUCO has taken in at least one other Docket. Staff also is concerned that Dr. Johnson offers no workable solutions to the significant issues in this case.

1 **II. Dr. Johnson's recommendation**

2 **Q. What is Dr. Johnson's primary recommendation?**

3 A. Dr. Johnson recommends that "the Commission reject the Proposed Settlement
4 Agreement, and move forward with a full hearing on all the issues that were raised during
5 the earlier stages of this proceeding."¹ Dr. Johnson justifies this recommendation by
6 stating that "It is not yet time to begin thinking about providing the Company with the
7 type of extreme pricing flexibility that it seeks through this proposal."² Staff finds it
8 difficult to reconcile Dr. Johnson's recommendation to go to hearing on the parties' pre-
9 settlement positions with his justification that the settlement offers too much pricing
10 flexibility. This is because in Staff's opinion the filed positions of many of the parties to
11 this case (including Qwest, RUCO, and Staff) actually advocated more pricing flexibility
12 for the Company than the Proposed Settlement Agreement does. Thus, rejecting the
13 Proposed Settlement Agreement and moving forward with a hearing on the parties'
14 original positions is likely to result in pricing flexibility for the Company in excess of
15 what is allowed for in the Proposed Settlement Agreement. This is precisely the result
16 that Dr. Johnson purports to want to avoid.

17

¹ Responsive Testimony of Ben Johnson, Ph.D. p. 23 line 21.

² Ibid. p.23 line 23.

1 **Q. Why does Staff believe that rejecting the Proposed Settlement Agreement and**
2 **moving forward with a hearing on the parties' original positions is likely to result in**
3 **pricing flexibility for the Company in excess of what is allowed for in the Proposed**
4 **Settlement Agreement?**

5 **A.** Many of the parties to this case (including RUCO, Staff and Qwest) advocated some kind
6 of geographic pricing flexibility often referred to as a "Competitive Zone" approach.
7 Under a Competitive Zone approach Qwest will be able to vary its rates across different
8 geographic areas. If the Company is allowed to vary its prices across geographic areas it
9 will enjoy much more pricing flexibility than it would under the Proposed Settlement
10 Agreement which requires state wide prices. Also, even absent any geographic flexibility,
11 the basket structure advocated by RUCO in their direct case allows for more pricing
12 flexibility than the basket structure in the Proposed Settlement (see the discussion of
13 basket structure below.)

14
15 **III. The Competitive Situation and the Basket Structure of the Proposed Plan**

16 **Q. What is Dr. Johnson's position on the competitive situation in Arizona's telecom**
17 **markets?**

18 **A.** Dr. Johnson's position on the competitive situation in Arizona is difficult to discern. Dr.
19 Johnson indicates at several points in his testimony that the Proposed Settlement does not
20 adequately account for the competitive situation in Arizona. However, at no point does he
21 adequately explain his assessment of the competitive situation in Arizona. Dr. Johnson
22 does indicate that he believes "competitive conditions have intensified since the
23 Commission approved the current plan."³ However, he never explains the nature of that
24 intensification.

25

³ Ibid. p. 10 line 4.

1 **Q. On the subject of the competitive situation in Arizona, are the statements made by**
2 **RUCO's witnesses consistent?**

3 A. No. RUCO's position on competition is inconsistent, in Staff's opinion. For instance at
4 page 10 starting at line 16 of his Responsive Testimony, Dr. Johnson argues that moving
5 certain services into Basket 2 would be detrimental because it would allow Qwest to raise
6 the price of those services to excessive levels. However, in footnote 2 on page 6 of her
7 Responsive Testimony RUCO witness Marylee Diaz Cortez argues that Qwest's ability to
8 raise prices on Basket 2 services is restricted by competition and thus the Proposed
9 Settlement's resolution of the April 1, 2005 adjustment is inadequate.⁴ It is difficult for
10 Staff to reconcile apparent inconsistencies such as this in the RUCO witnesses' testimony
11 on the Proposed Settlement Agreement.

12
13 **Q. Are there other inconsistencies in Dr. Johnson's testimonies that are worth**
14 **mentioning?**

15 A. Yes. As alluded to above, Dr. Johnson's discussion of the Plan's basket structure
16 demonstrates that he may not understand the provisions of the Proposed Settlement
17 Agreement.

18
19 Dr. Johnson acknowledges that competitive conditions have intensified since the
20 Commission approved the current plan.⁵ To account for this intensified competition Dr.
21 Johnson recommends a price cap plan with three baskets: Moderate Pricing Flexibility
22 Services; High Pricing Flexibility Services; and Total Pricing Flexibility Services. In his
23 Direct Testimony filed on November 18, 2004, at page 184 lines 4-6, Dr. Johnson
24 explained that RUCO's Moderate Pricing Flexibility basket (which would replace the

⁴ See the Surebuttal Testimony of Staff witness Elijah Abinah for a full discussion of Staff's response to Ms. Cortez's arguments concerning the Proposed Settlement's resolution of the April 1, 2005 adjustment.

⁵ Ibid. p. 10 line 4.

1 current Basket 1) would allow individual rate elements to increase by 25 percent per year.
2 However, at page 10 line 16 thru page 11 line 13 of his Responsive Testimony, Dr.
3 Johnson criticizes the Proposed Settlement Agreement because it allows certain services to
4 move from Basket One to the new Basket Two which has a cap on individual rate
5 elements of 25 percent per year (in addition to an overall revenue cap.) Here, contrary to
6 his Direct Testimony, Dr. Johnson seems to indicate that the 25 percent per year cap is not
7 justified by the current level of competition.
8

9 **Q. So to summarize the issues concerning basket structure, in his direct testimony Dr.**
10 **Johnson advocated applying a 25 percent per year individual rate cap to *all* services**
11 **in the basket with the lowest pricing flexibility, yet in his Responsive Testimony he**
12 **indicates that competitive conditions do not justify moving a *subset of* services in that**
13 **basket to the new Basket 2 which has the same 25 percent per year individual rate**
14 **cap.**

15 **A. That is correct.**
16

17 **Q. Please compare the basket structure contained in the Proposed Settlement**
18 **Agreement with the basket structure advocated by RUCO in their direct case.**

19 **A. The Proposed Settlement Agreement advocates placing Qwest's services into four baskets:**

20 Basket 1: Hard Capped services, no pricing flexibility.

21 Basket 2: Services that are subject to a 25 percent individual cap and an
22 overall revenue cap. (The increases in revenues are capped.)

23 Basket 3: Services that are subject to a maximum rate caps pursuant to A.A.C.
24 R14-2-1109 and R14-2-1110 and an overall revenue cap. (The
25 increases in revenues are capped.)

26 Basket 4: Wholesale services.

1
2 In RUCO's direct case Dr. Johnson advocated placing Qwest's services into three baskets:

3 Moderate Pricing Flexibility Services: 25 percent individual rate cap and an
4 overall revenue cap and GDP-PI
5 minus 4.2 percent productivity
6 offset.⁶

7 High Pricing Flexibility Services: 25 percent individual rate cap and an
8 overall revenue cap that *increases*
9 *annually* by two times the change in
10 GDP-PI.⁷

11 Total Pricing Flexibility Services: Individual rate caps pursuant to
12 A.A.C. R14-2-1109 and R14-2-1110
13 and *NO* overall revenue cap.⁸

14 Staff believes that the RUCO basket structure proposal would provide Qwest with more
15 pricing flexibility across the whole range of services than the proposed settlement's basket
16 structure. In spite of this Dr. Johnson states: "The high degree of pricing freedom that
17 would be granted Qwest under the proposed settlement is not consistent with the limited,
18 inconsistent state of competition in much of Qwest's Arizona service territory."⁹ Staff
19 simply can not reconcile this contradiction.
20

⁶ Direct Testimony of Dr. Ben Johnson, filed November 18, 2004, page 184 lines 1 thru 6.

⁷ Ibid, page 188 lines 17 thru 20.

⁸ Ibid, page 190 lines 3 thru 5.

⁹ Responsive Testimony of Ben Johnson, Ph.D. page 3 lines 4 thru 6.

1 Q. Dr. Johnson also advocates accounting for geographic variation in competition
2 through the assignment of services to the baskets. Would accounting for geographic
3 variations in competition this way resolve the contradiction inherent in Dr.
4 Johnson's testimony?

5 A. No. Under Dr. Johnson's proposal a service that is experiencing different levels of
6 competition across the State could be placed in several baskets simultaneously, e.g., a
7 service could be placed in the Moderate Pricing Flexibility Services basket in rural areas
8 and the Total Pricing Flexibility Services basket in urban areas. However, this would still
9 result in more pricing flexibility for Qwest than the Proposed Settlement allows. This is
10 because RUCO's Moderate Pricing Flexibility Services basket offers significant pricing
11 flexibility.
12

13 Q. Does Dr. Johnson make any incorrect statements about the basket structure of the
14 proposed plan which lead Staff to conclude he may not understand the provisions of
15 the Proposed Settlement Agreement?

16 A. Yes. At page 6 of his Responsive Testimony Dr. Johnson makes several incorrect
17 statements. First at page 6 line 7 Dr. Johnson states that there are no individual price caps
18 on Basket 3 services. This is incorrect; the Proposed Settlement Agreement provides that
19 maximum rates will be established for these services pursuant to A.A.C. R14-2-1109.¹⁰
20 Also, at page 6 line 9, Dr. Johnson states that wholesale services in Basket 4 are "capped
21 at current tariff or contract levels for the duration of the plan." This is not correct; the
22 Proposed Settlement Agreement at page 9 is clear that wholesale prices can change as
23 contracts are renegotiated or if the Commission, the FCC or the courts determine that
24 other prices are appropriate. Additionally, at page 6 line 12, Dr. Johnson states that
25 "Qwest can raise rates for Basket 2 and 3 services to generate up to an *additional* \$43.8

¹⁰ See Section 25, Page 18 of the Proposed Settlement Agreement.

1 million in revenues.”¹¹ This also demonstrates a misunderstanding of the Proposed
2 Settlement Agreement’s terms and conditions; the additional revenue is \$31.8 million.
3 The \$12 million associated with the access charge reduction is not new or additional
4 revenue for Qwest. It is included in the plan to account for revenue reductions due to
5 changes in access charges.

6
7 Also, at page 13 line 8 of his Responsive Testimony, Dr. Johnson indicates that revenues
8 from Basket 2 services can increase up to \$43.8 million under the Proposed Settlement.
9 This is incorrect; under the Proposed Settlement, revenue increases from Basket 2 can not
10 exceed \$13.8 million.

11
12 Additionally, on page 11 lines 1 thru 3 of his Responsive Testimony, Dr. Johnson
13 indicates that caller ID block is moving from being hard capped to being subject to the 25
14 percent individual rate cap under the new Basket 2. In fact, caller ID block is not moving
15 to the new Basket 2 under the Proposed Settlement Agreement. The Proposed Settlement
16 Agreement calls for keeping caller ID block in Basket 1 (see Appendix A 1 to the
17 Proposed Settlement Agreement.)

18
19 Furthermore, at page 11 line 21 of his Responsive Testimony, Dr. Johnson states that
20 exchange zone increments for second lines would move from Basket 1 to Basket 2 under
21 the Proposed Settlement. This is not the case; the Proposed Settlement does not call for
22 moving exchange zone increments for second lines from Basket 1 to Basket 2.
23

¹¹ Emphasis added.

1 **IV. Assignment of Services to Specific Baskets**

2 **Q. Does Dr. Johnson take issue with the assignment of specific services to specific**
3 **baskets under the Proposed Settlement Agreement?**

4 A. Yes. Dr. Johnson takes issue with moving additional lines and exchange zone increments
5 associated with additional lines from Basket 1 to Basket 2.¹² Dr. Johnson is mistaken in
6 his belief that the Proposed Settlement moves exchange zone increments associated with
7 additional lines from Basket 1 to Basket 2. Under the Proposed Settlement Agreement all
8 exchange zone increments are included in Basket 1 (See Appendix A 1 to the Proposed
9 Settlement.) Additionally, Section 13(a) of the Proposed Settlement Agreement contains a
10 provision to cut the exchange zone increment rates in half.

11
12 With respect to additional lines Dr. Johnson states that “under the Proposed Settlement,
13 revenues from Basket 2 services can increase up to \$43.8 million, so the additional line
14 rates could immediately be increased by 25 percent, and Qwest could thereafter increase
15 these prices by as much as 25 percent per year, until they reach monopoly profit-
16 maximizing levels.”¹³ This statement is problematic for a variety of reasons. First, as
17 stated above Basket 2 services can **NOT** increase up to \$43.8 million. That number is the
18 total cap on Basket 2 and Basket 3. Second, the Proposed Settlement also requires
19 maximum rates be established on Basket 2 services pursuant to A.A.C. R14-2-1109 and
20 1110.¹⁴ Thus, the Commission would have an opportunity to check price increase as
21 described by Dr. Johnson. Third, and most importantly, Dr. Johnson offers no
22 justification for his statement that Qwest would be able to charge monopoly rates for
23 second lines. Staff’s analysis indicates that second lines are effected by competition to a
24 greater extent than are primary lines. This is because Cox, Qwest’s primary competitor in

¹² Responsive Testimony of Ben Johnson, Ph.D. page 10 lines 18 thru 22.

¹³ Ibid, Page 13 lines 7 thru 10.

¹⁴ See Section 25, Page 18 of the Proposed Settlement.

1 urban areas, also offers second lines. Also, and more significantly, wireless phones are a
2 closer substitute for second lines than they are for primary lines. For instance in the past a
3 family might buy a second line for their teen age children but now wireless phones serve
4 that purpose. It should be noted that wireless service is available over a greater
5 geographic area than is CLEC service. In short, Staff's decision to agree to move second
6 lines into Basket 2 was based on our assessment of the market. Dr. Johnson offers no such
7 assessment.

8
9 **Q. On page 11 lines 1 thru 3 of his Responsive Testimony, Dr. Johnson indicates that**
10 **both PBX Trunks and caller ID block are moving from being hard capped to being**
11 **subject to the 25 percent individual rate cap under the new Basket 2. Please discuss.**

12 **A.** First, caller ID block is not moving to the new Basket 2 under the Proposed Settlement
13 Agreement. The Proposed Settlement Agreement calls for keeping caller ID block in
14 Basket 1 (see Appendix A 1 to the Proposed Settlement Agreement.) This is another
15 example of Dr. Johnson's apparent misunderstanding of the Proposed Settlement.

16
17 With respect to PBX trunks Staff believes that it is appropriate to move this service to the
18 new Basket 2. PBX trunks are used exclusively by business customers and primarily by
19 larger business customers. Staff's analysis indicated that there are legitimate competitive
20 alternatives for Qwest's PBX trunk service. Dr. Johnson offers no justification for his
21 criticism of the Proposed Settlement Agreement's treatment of PBX trunks.

22

1 **Q. Dr. Johnson also takes issue with moving certain services into Basket 3 under the**
2 **Proposed Settlement.¹⁵ Please comment.**

3 A. Again Dr. Johnson offers no justification for his contention that these services do no
4 belong in Basket 3. Dr. Johnson takes particular exception with the movement of service
5 packages into Basket 3 under the Proposed Settlement Agreement. At page 14 line 17 of
6 his Responsive Testimony Dr. Johnson states that, "The limited degree of competition
7 which currently exists for local exchange services is not sufficient to justify giving Qwest
8 complete freedom to increase prices for these local exchange service packages." First the
9 Proposed Settlement Agreement does not give Qwest complete freedom to increase prices
10 for its packages. Section 23 of the Proposed Settlement Agreement includes safeguards
11 regarding packages that would make unlimited price increases impossible. For instance,
12 the price of a package is capped at the sum of the highest prices of the individual services
13 in the package. So contrary to Dr. Johnson's assertion Qwest will not have "complete
14 freedom" to increase the prices of its service packages.

15
16 **Q. Dr. Johnson takes issue with the assignment of certain services to Baskets in the**
17 **Proposed Settlement Agreement. Has RUCO taken a position on which services**
18 **should be in which baskets?**

19 A. No. Neither in his Responsive Testimony nor in his Direct Testimony does Dr. Johnson
20 list the services that he believes should be in each Basket. He describes at length the type
21 of analysis he thinks should be done to assess the competitiveness of services but he does
22 not actually perform the analysis.
23

¹⁵ Responsive Testimony of Ben Johnson, Ph.D. page 13 lines 11 thru 16

V. Geographic Differences

Q. Dr. Johnson criticizes the Proposed Settlement Agreement because it does not address differences in the level of competition across geographic areas.¹⁶ Please comment on Dr. Johnson's assertions regarding geographic variations in competition.

A. Dr. Johnson claims that the Proposed Settlement Agreement "leaves customers in high cost rural areas vulnerable to excessive price increases..."¹⁷ Staff does not agree with this assessment. Under the Proposed Settlement Agreement Qwest can not raise any rates in rural areas without also raising the same rates in urban areas (i.e., the Proposed Settlement continues the current regime of state wide rates.) Thus if Qwest were to raise a particular rate in order to take advantage of its monopoly position in the rural areas it would face the substantial risk of losing customers to competition in the urban areas. Thus, Staff believes that under the Proposed Settlement Agreement, competition in urban areas will restrict Qwest's ability to raise rates in both urban and rural areas.

Q. Dr. Johnson advocates determining the geographic differences in competition and using that determination in assigning services to Baskets so that one service could be in multiple Baskets depending on geography.¹⁸ Has Dr. Johnson actually done the analysis necessary to make such a determination?

A. No. Dr. Johnson advocates that such analysis should be done but he has not actually done it.

¹⁶ Ibid, page 15 line 11.

¹⁷ Ibid, page 19 lines 2 thru 3.

¹⁸ Direct Testimony of Dr. Ben Johnson p. 168 lines 7 thru 16.

1 **Q. Does Staff believe that Dr. Johnson's approach will result in greater protections for**
2 **rural customers than the Proposed Settlement Agreement?**

3 A. No. On the contrary Dr. Johnson's recommended approach would put rural customers of
4 Qwest in a great deal of risk. Under Dr. Johnson's proposal, Qwest would be able to
5 increase its rates (including basic service rates) by as much as 25 percent a year. Since
6 urban and rural rates are decoupled under Dr. Johnson's proposal Qwest would be able to
7 cut rates or keep rates constant in urban areas where there is competition while
8 simultaneously raising rates in rural areas by as much as 25 percent a year.

9
10 **Q. Does the Proposed Settlement Agreement offer any direct benefits for rural**
11 **customers?**

12 A. Yes. Under the Proposed Settlement Agreement the current exchange zone increment
13 rates (that Dr. Johnson seems so concerned about) will be cut in half. Section 13(a) of the
14 Proposed Settlement calls for reducing Zone 1 charges from \$1.00 to \$0.50 per month and
15 Zone 2 charges from \$3.00 to \$1.50. Also, under the Proposed Settlement Agreement
16 exchange zone increment rates will be hard capped. These exchange zone increments
17 apply to customers whose locations are a considerable distance from the Qwest central
18 office.

19
20 **VI. Arizona Universal Service Fund**

21 **Q. Dr. Johnson criticizes the Proposed Settlement because it does not include provisions**
22 **for revamping the Arizona Universal Service Fund ("AUSF").¹⁹ Please comment.**

23 A. Staff believes this docket is an inappropriate venue to address the AUSF. There is
24 currently a generic docket open to address the AUSF (RT-00000H-97-0137.) A generic
25 docket is the most appropriate vehicle for addressing the AUSF. Changes to the AUSF

¹⁹ Responsive Testimony of Ben Johnson, Ph.D. page 19 line 15 thru page 20 line 14.

1 will have statewide effects. Such changes will affect many Arizona telecommunications
2 providers in addition to Qwest. Most of those providers are not parties to the current case.
3 It would be neither fair nor practical to include changes to the AUSF within this
4 settlement. Many parties who would be affected by changes to the AUSF were not parties
5 to this case and were thus not involved in settlement negotiations on this case.
6

7 **Q. There is currently a generic docket open to address the AUSF (RT-00000H-97-0137).
8 Has RUCO taken a position in that docket?**

9 A. On July 25, 2005, RUCO did file comments in that docket responding to an Arizona Local
10 Exchange Carriers Association ("ALECA") proposal. In those comments RUCO did not
11 mention any need for revisions to the AUSF. Staff struggles to understand this apparent
12 discrepancy between Dr. Johnson's position in this case and RUCO's filing in the generic
13 docket on AUSF.
14

15 **Q. In his Direct Testimony did Dr. Johnson provide any recommendations for specific
16 changes in the AUSF?**

17 A. No. In his Direct Testimony Dr. Johnson devotes 51 pages to discussions of the AUSF
18 (pages 27 thru 78). However, Staff was unable to discern any specific recommendations
19 concerning changes to the AUSF within those pages.
20

21 **Q. So to summarize the AUSF issue, Dr. Johnson made no recommendations regarding
22 changes to the AUSF in his Direct Testimony in this case and RUCO has not
23 advocated changes to the AUSF in the generic AUSF docket, yet Dr. Johnson
24 criticizes the Proposed Settlement because it does not address changes to the AUSF.**

25 A. That is correct.
26

VII. Other Issues

Q. At page 2 line 20 and 21 Dr. Johnson states that, "The proposed plan includes few, if any, changes which would benefit residential and other mass market customers." Does Staff agree?

A. No. The Proposed Settlement Agreement includes several provisions intended to result in direct benefits for Qwest's customers. For instance Section 13(a) of the Proposed Settlement Agreement provides for a reduction in zone charges of 50 percent (discussed above), Section 13(b) provides for reductions in the rates for Non-Published and Non-Listed telephone numbers, 13(c) provides for increased funding for the medically needy program, and Section 16 of the Proposed Settlement Agreement provides for an increase in Qwest's line extension credit.

VIII. Conclusion

Q. What are Staff's conclusions regarding Dr. Johnson's Responsive Testimony?

A. Dr. Johnson's Responsive Testimony appears to be inconsistent with the testimony of RUCO witness Marylee Diaz Cortez and his own Direct Testimony at times. Dr. Johnson's Testimony also appears to have several internal inconsistencies and oftentimes does not accurately portray the proposed Settlement Agreement. It also appears to be inconsistent with positions RUCO has taken in at least one other Docket. Staff also is concerned that Dr. Johnson offers no workable solutions to the significant issues in this case.

For the above reasons Staff recommends that the Commission discount Dr. Johnson's recommendations in its deliberations on this matter.